

## **STATE TREASURER'S OFFICE**

### **INVESTMENT PROTECTION STANDARDS**

Effective July 1, 2002, The State Treasurer of California imposed a set of Investment Protection Principles (hereinafter “the Principles”) on every financial organization that provides investment-banking services and is retained or utilized by the State of California. The Principles were originally based on the terms of the agreement between Merrill Lynch & Co., Inc. and New York State Attorney General Eliot Spitzer dated May 21, 2002. On April 28, 2003, the New York Attorney General, the Securities and Exchange Commission, the New York Stock Exchange, NASD, and the North American Securities Administrators Association announced a settlement with ten of the nation’s largest investment firms (hereinafter “the Global Settlement”), the terms of which significantly reduce the conflicts of interest between Research and Investment Banking (as those terms are defined in the Global Settlement). Accordingly, the State Treasurer has modified Part A of the Principles to incorporate the relevant terms of the Global Settlement and has elevated such Principles to mandatory Standards (hereinafter “the Standards”) for all financial organizations, as previously defined by this Office. Effective May 8, 2003, the State Treasurer’s Office has adopted as a minimum requirement that all firms doing business with this Office must comply with the Standards. Firms had until October 1, 2003 to submit policies and plans regarding compliance with the Standards. A list of companies in compliance is available on the Treasurer’s website ([www.treasurer.ca.gov/Corporate Reform](http://www.treasurer.ca.gov/Corporate_Reform)), and will be updated regularly.

The Investment Protection Standards include, but are not limited to, the following:

- Severing the link between compensation for analysts and Investment Banking.
- Completely separating Research and Investment Banking, including physical separation. Research will not report directly or indirectly to or through Investment Banking.**
- Requiring that Research have its own dedicated legal and compliance staff.**
- Requiring firms to create and enforce firewalls reasonably designed to prohibit all communications between Research and Investment Banking.**
- Prohibiting Research from participating in efforts to solicit investment-banking business. Analysts may not participate in “pitches” or Investment Banking sponsored road shows.**
- Prohibiting Investment Banking input into analyst compensation.
- Establishing written criteria (exclusive of Investment Banking input) to be used for compensation decisions.**

**-Compensating analysts in significant part based on the quality and accuracy of their work.**

**-Investment Banking shall have no input into an analyst's evaluation.**

**-Decisions concerning compensation shall be documented.**

**-Creating a review committee to approve all research recommendations.**

**-The review committee will review all changes in ratings, if any, and material changes in price targets, if any, contained in the firm's research reports.**

**-The review committee will conduct periodic reviews of research reports to determine whether changes in ratings or price targets, if any, should be considered.**

**-The review committee will monitor the overall quality and accuracy of the firm's research reports.**

**-Requiring that upon discontinuation of research coverage of a company, firms will disclose the coverage termination and the rationale for such termination.**

**-Prohibiting Investment Banking input into company-specific coverage decisions (i.e., whether or not to initiate or terminate coverage of a particular company in research reports furnished by the firm).**

**-Disclosing in research reports whether the firm has received or is entitled to receive any compensation from a covered company over the past 12 months.**

**-Each quarter, firms shall publish on their websites a chart showing their analysts' performance, including each analyst's name, ratings, price targets, and earnings per share forecasts for each covered company, as well as an explanation of the firm's rating system.**

**-Establishing a monitoring process to ensure compliance with the principles.**

**-Each firm shall conduct an annual review to provide reasonable assurance that the firm is in compliance.**

**-The State Treasurer's Office reserves the right to request an independent audit or confirmation of compliance with these Standards, and, in the case of those firms party to the Global Settlement, a copy of the report prepared by the Independent Monitor.**

**Notes:** (1) The provisions in **bold** represent new requirements not previously contained in the Investment Protection Principles adopted in July 2002.

(2) Upon approval by the State Treasurer's Office of a firm's plan or policy, these Standards are to be implemented consistent with the timeframes established in the Global Settlement. In submitting plans, a firm may propose a specific alternative method for complying with one or more of the Standards, which will be considered only if such alternative method is consistent with the intent of the Standards and achieves the same substantive objective.